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FINDING HIDDEN ASSETS IN DIVORCE CASES

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I. PRELIMINARY STEPS IN A HIDDEN ASSET INVESTIGATION

Claims that one spouse is hiding assets from the other are common during a divorce. All hidden asset claims need to be investigated, even though many will turn out to be baseless. The investigation may be done by a divorce attorney or a financial investigator or a combination of the two. Regardless of who investigates, the investigator needs to answer three preliminary questions:

- Did the suspected spouse have any opportunity to hide assets?
- Are hidden assets a possibility, or did the couple simply spend everything they earned?
- Assuming hidden assets are a possibility, during what time frame did the hiding most likely occur?

These questions must be answered to define the scope of the investigation and avoid a possibly fruitless and expensive wild goose chase.

WHAT SYSTEM DID THE COUPLE USE TO MANAGE THEIR FINANCES?

The investigator must first understand how the couple handled their finances. Married couples handle their finances in numerous ways. These range from one spouse controlling everything, to the couple making every financial decision together. In between, the husband or the wife could be given a household allowance to manage the family's living expenses.

Some couples have only a joint checking account, while others have three checking accounts: his, hers, and joint, with the joint account being used to run the household.

In a large percentage of the systems devised by couples, one person has more knowledge of the couple's finances than the other.

> ***Example:*** Tim and Linda have developed a system in which Linda handles the finances. Tim's paycheck is directly deposited into their joint account and he is given an allowance of $100 per week for lunches and miscellaneous expenses. Linda pays the mortgage, the credit cards, groceries, retirement savings, and makes all of the financial decisions. Tim, therefore, has very little idea of how the couple spent their money or even how much it costs to live.

DID THE SUBJECT SPOUSE HAVE OPPORTUNITY?

No matter what system the couple has devised, the investigator must understand it. This understanding tells the investigator who controlled the couple's assets and income. The spouse more likely to be hiding assets is the one who has the most control. Normally, that is the higher earner.

Essentially, control equals opportunity. If one spouse had exclusive control of an asset or income stream, then he or she could possibly have misdirected it.

WHAT INCOME DID THE COUPLE HAVE AND HOW DID THEY SPEND IT?

The investigation will move from the general financial operations of the couple to the specific. The investigator will learn about what income was available to the couple and how they spent it.

The investigator should share this information with the spouse making claims of hidden assets. Claims of hidden assets are most often brought by the spouse with less control of the couple's assets. Educating this spouse about the couple's financial realities will, in some cases, make accusations of hidden assets evaporate. In other cases, it will provide the investigator with a direction for pursuit of the missing assets.

ARE HIDDEN ASSETS A POSSIBILITY?

A significant proportion of hidden asset claims in divorces result from a skewed perception of the amount of money earned versus the amount of money spent. The more money a couple earns, the more they are likely to spend to increase the family's standard of living. Therefore, one of the first things an investigator attempts to establish is whether the couple has simply spent all their money or whether expenditures are less than income allowing for the possibility of hidden assets.

When this question isn't answered at the outset, time and money can be wasted trying to solve an imaginary problem. Establishing that hidden assets are unlikely or impossible curtails expensive investigations. On the other hand, establishing the possibility of hidden assets gives an investigation credibility and direction. It is then easier to get access to information needed to complete the investigation. Once evidence of the possibility of hidden assets is produced, courts are more likely to order the suspected party to turn over relevant financial information. The other party may even comply voluntarily without court intervention because he or she knows little will be gained by resisting.

THE FORMULA FOR DETERMINING THE POSSIBILITY OF HIDDEN ASSETS

Investigators use this formula to determine the possibility of hidden assets:

Assets (including income) - Expenditures = Missing Income or Hidden Assets

> ***Example:*** A husband discovers his wife won $10,000 in a state lottery according to a list of winners published in the newspaper. A review of the couple's bank statements does not show a $10,000 deposit to the couple's joint bank account. Therefore, the asset existed under the control of the wife and is missing.

The formula also applies to the income or earnings generated by a couple. The income of the parties is determined, the expenditures of the parties are determined, and the difference either confirms or denies the possibility of hidden assets.

The formula can be as simple as the example or encompass dozens of assets and numerous income streams. It can be used to provide the basis for continuing an investigation when it reveals the possibility of hidden assets or curtailing an investigation when it illustrates that hidden assets are unlikely. Finally, the formula can be an end in itself. In our example, a court may deem that the completion of the formula is enough to assess the wife the $10,000 in the marital estate division. That is, the existence is shown, expenditure is not; therefore, the wife is assumed to have the asset.

SETTING A TIME FRAME FOR THE INVESTIGATION

Investigators refer to the date on which the asset hiding began as "the date of first indication." Investigations after this date are likely to produce worthwhile results while investigations focusing on time periods before this date are not.

The date of first indication is usually the point the spouse hiding the assets recognizes that the marriage is unlikely to continue, for example, the date of an argument where physical violence erupted. Another common date of first indication is when one spouse begins an affair or the other discovers it. Changes in behavior of either party will give the investigator clues as to when to begin the search.

Identifying the date of first indication and limiting the time period for the investigation is important. First, it limits the costs of the investigation. Second, it avoids onerous discovery for the party being investigated. That party may protest (with justification) that the discovery is overly burdensome and seek protection from the court. If the court agrees, then valuable information will be lost.

> ***Example:*** An investigator asks for credit card statements and receipts from a husband for the last ten years. The husband protests. The court agrees that the request is excessive and protects all of the information from production. However, the husband is likely to have been hiding assets only since the date his marriage was in jeopardy. Suppose that was when he began having an affair two years ago. A court would be less likely to consider a discovery request that goes back two years excessive. If expenditures are discovered that lead to hidden assets, a court is more likely to grant additional discovery requests for periods before the date of first indication.

FOLLOWING THE PAPER TRAIL

Hidden asset investigations are matter of following a paper trial. All assets have a history that is recorded on paper. They are purchased (or traded for), insured, taxed, appraised, maintained, repaired, and finally traded, sold, or scrapped. Each stage of their existence can leave evidence as to their existence and perhaps value.

> ***Example:*** Bill bought an unmounted diamond, which he kept secret from his wife. Bill wrote a check for the diamond. At the time of purchase, the jeweler provided a receipt. After the time of purchase, Bill asked for an appraisal so that he could insure the piece in an insurance rider. Bill then dropped the rock into his new safety deposit box. The paper trail consists of the check written for the diamond, the receipt from the jeweler, the appraisal, the insurance policy with rider, and the payments for the safety deposit box. Each of these items, if found, provides evidence of the existence of the asset.

The "if found" of course is the problem. Fortunately, most divorcing couples are not criminals and are unpracticed in the art of deception. Complex plans take time and logical thinking to put into play. A person under high stress with little time, as is typical during a divorce, may not be able to formulate schemes that will avoid detection. Consequently, picking up the ends of paper trails is often not a challenge for experienced investigators. However, getting the information necessary to perform a competent investigation is often a problem.

If an investigator requests everything that may turn up a hidden asset, the opposing attorney will undoubtedly accuse the investigator of conducting a fishing expedition and claim that the discovery request is overly burdensome. Judges often buy into the argument saying essentially, "If you can't tell me what you are after, you can't have the information." If the investigators knew exactly what they were after, they wouldn't have to ask for the information. Therefore, hidden assets investigators must painstakingly build from the known to the unknown using information that is available to convince the judge that further financial disclosure from the suspected spouse is warranted.

II. INFORMATION GATHERING AND ANALYSIS

DOCUMENTS NEEDED TO BEGIN THE INVESTIGATION

The following documentation is usually necessary to begin an investigation into hidden assets:

- Divorce financial disclosures.
- Tax returns.
- Bank statements.
- Check registers.

Pay stubs of the spouse being investigated also frequently reveal useful information if they can be obtained.

FINANCIAL DISCLOSURES

Typical divorce procedures require that a divorcing couple disclose their assets and liabilities to each other. These disclosures serve as the starting point in any financial investigation seeking assets that have been excluded from the marital estate.

TAX RETURNS

A tax return may be an imperfect representation of the actual economic income of the person filing the return. However, a tax return showing significant income increases the odds that a claim of hidden assets might be valid. A tax return showing little or no income should prompt the question, "If assets are being hidden, where did they come from?"

Tax returns also provide authoritative documentation concerning sources of income. For example, the payor of interest reports the payment to the IRS. This usually means that the recipient of the interest will report it on his or her tax returns. If the tax returns show interest income, but the spouse discloses no asset that would generate interest income, the basis for an inquiry arises.

BANK STATEMENTS

A couple's bank account usually serves as the financial framework of the marriage. The monthly bank statements provide evidence of what went into the account and what was paid out. They quickly show all income and all expenses and can reveal missing income and the relationship between the couple's income and their expenditures. Bank statements are also useful in identifying inter account transfers, and automatic payments, and may reveal unusual transactions. However, while the bank statements record deposits and checks, they do not usually provide the detail necessary to analyze specific transactions. Therefore, obtaining the couple's check registers is necessary.

CHECK REGISTERS

Check register is an accounting term that refers to the part of a check book where the deposits to and expenditures from to a checking account are recorded. Check registers are generally found in three forms. The first is totally manual. That is, every deposit and expenditure is recorded by hand, in a register provided at the back of the check book. The second is a duplicate system. That is, when a person writes a check, a copy of it is produced. The copy has a place to keep a running balance and to record deposits. The third is electronic. As information technology becomes the norm, more and more individuals will move toward paperless transactions. For example, automatic withdrawals from checking accounts to make loan payments are paperless transactions. However, paperless or not, all transactions give rise to evidence that can be pursued in discovering hidden assets.

PAY STUBS

Following the money often leads back to the original evidence of a transaction between an employee and employer, the pay stub. Pay stubs can reveal misstated income and suspicious deductions, as well as diverted income and where it was ultimately deposited. Even if an employee is paid by electronic funds transfer (direct deposit), the employer will furnish the employee with a pay stub.

CASE STUDY #1: THE SECRET ACCOUNT

Interviewing the complaining spouse. Amy told her divorce attorney that she suspected her husband, Mitch, of hiding assets. Amy had no proof, but she was surprised at how little his financial disclosures showed that the couple owned. Amy also had discovered that Mitch was having an affair, which was the cause of their divorce. The attorney referred the case to a forensic investigator.

The investigator began by interviewing Amy to find out (1) where the family's money comes from; (2) what the money was spent on; (3) whether Mitch had control over the money and thus the opportunity to hide assets; (4) during what time frame was the hiding most likely to have occurred.

The investigator discovered the following facts:

- Mitch worked as an executive for a telecommunications company. Amy didn't know his exact salary, but believed he was well compensated.
- Amy did not work outside the home and Mitch's salary was the family's only source of income.
- Amy believed her husband's affair had been going on for about 18 months.
- She and her husband had a very comfortable lifestyle that included vacations in Europe, a housekeeper, and frequent dining out.
- Mitch's paycheck was deposited directly to their joint checking account, from which all living expenses were paid.
- Amy had bank statements and check registers, but did not have the couple's tax returns or Mitch's paystubs. The investigator told her to go to the family CPA and obtain copies of their tax returns, which Amy did.

From this interview, the investigator concluded that Mitch, as the sole breadwinner with a comfortable salary, had the ability to hide assets; further investigation of the couple's finances was warranted; and the appropriate period to investigate was the past two years during which Mitch began the affair.

The tax returns shows missing money. Amy and the investigator reviewed bank statements for the couple's checking account for the past two years and didn't find anything unusual. If Mitch was hiding assets, he wasn't doing it through the checking account.

Mitch's W-2, which Amy obtained from their CPA as part of their tax returns, revealed Mitch was paid a net income after taxes last year of $140,906. Bank statements showed total deposits to the joint checking account for the past year of $115,456, leaving $25,450 unaccounted for.

Pay stubs reveal a hidden account. Amy's attorney used the calculation of the missing money to persuade a judge to order Mitch to turn over his pay stubs. They showed that Mitch was having $750 per month direct deposited to a saving account held in his name only. At the time of its discovery, the account had a balance of approximately $5,000. Analysis of all of the pay stubs revealed total deposits to the secret savings account over a two-year period of $39,000.

Getting an admission from Mitch. Amy now had evidence that Mitch had access to $39,000 of which $34,000 was missing and that he had intended to keep the diversion of income and the savings account secret. In a perfect world the judge would consider this enough prove that Mitch had received $34,000 of the marital estate and that this amount should be credited to his side of the equation. However, some courts are reluctant to make this kind of judgment even when faced with evidence of access and attempts to conceal.

In many jurisdictions, including where Amy's divorce was pending, expenditures for necessities of life are allowed without being assessed to the spending party. If Mitch had used the funds for necessities for himself or his family, they would be excluded from consideration in the marital estate division. However, if he had spent them on luxuries, hobbies, or a new love interest, Amy's claim that they should be part of Mitch's portion of the marital estate would have substance.

Amy's attorney attempted to force Mitch to reveal the nature of the expenditures that were made from the savings account. Mitch responded that he spent the money on living expenses since the separation and that he destroyed any evidence of the nature of the expenditures stating, "Who saves grocery receipts?"

The pay stubs reveal another secret. During the review of the pay stubs, Amy and the investigator noticed that Mitch had taken vacation pay. Amy found it puzzling because she hadn't been on vacation with him when the vacation pay was being drawn. Amy's attorney decided to depose Mitch under oath. The attorney asked him how he paid for the vacation and with whom he went.

Mitch admitted he took money from the secret savings account to pay for the vacation and that his girlfriend, Rosalind, accompanied him. If he hadn't, Amy's attorney could have subpoenaed Rosalind. Mitch's attorney saw the writing on the wall and advised his client to accept the assessment of $34,000.

CASE STUDY #2: THE SECRET TAX REFUND

An unexplained discrepancy. Charla and Joel, a CPA, were divorcing. To Charla's attorney, Joel seemed to have complied with all discovery and apparently was being very forthright in all of his disclosures. However, an analysis of Joel's income and the family's expenditures revealed a discrepancy. It looked like Joel was earning more than he and his family were spending.

Joel worked as a financial officer of a large corporation and received a paycheck every two weeks. He made about $85,000 per year and his pay stubs, at first glance, didn't reveal anything unusual. The difference between earnings and spending was still not explained. A closer examination was in order.

Tax withholding seems high. One of the differences between earnings and deposits is tax withholding. That is, what you earn is not what you take home because taxes are withheld from your salary. Charla's attorney divided all of the taxes Joel had withheld or had paid in the previous year (Federal, state, FICA, and Medicare) by the amount of his gross salary. The result was around 39% (33,000 ÷ 85,000) which seemed high.

Calculations confirm excessive withholding. Using withholding tables available from the IRS, the attorney estimated the amount of taxes that Joel should have expected to pay. Joel's federal withholding for the preceding year was $14,000. The withholding table calculation revealed that an amount closer to $7,000 was in order. Next, the attorney performed a similar analysis for state taxes. The expected tax was about $4,000 while the amount withheld was $8,000.

Joel had doubled the amount of Federal and state withholding that would normally be expected at his earnings rate. He had paid the IRS $7,000 (14,000 - 7,000) and the state $4,000 (8,000 - 4,000) that he would receive back when he filed his tax return for the year under review. Charla's attorney made a claim for $11,000 (7,000 + 4,000) of undisclosed assets. Joel and his attorney eventually conceded the point.

Had they not, Charla probably would have had to hire another CPA to create the actual or a hypothetical tax return to prove that the tax liabilities anticipated by Joel were overstated.

III. DIGGING DEEPER WITH FINANCIAL STATEMENTS

TYPES OF FINANCIAL STATEMENTS

The term "financial statements" normally refers to the balance sheet and the income statement of an enterprise. Essentially, what a business (or individual or couple) owns and what it earns, respectively. Other statements may be included in a set of financial statements, but financial investigations related to a divorce are usually restricted to the basic statements.

BALANCE SHEETS

Balance sheets are documents that summarize the assets and liabilities of individuals, businesses, and marital estates.

The most basic accounting equation illustrated by the balance sheet is:

Assets = Liabilities + Equity

It can also be restated:

Assets − Liabilities = Equity

That is, everything that an entity owns less everything that it owes equals its equity or net worth. For example, assume that a business has $20,000 in cash and real estate that it purchased for $80,000. Its total assets equal $100,000. Assume also that the business owes $60,000 on the real estate. The net worth of the business is then $40,000 (100,000 – 60,000 = 40,000).

Balance sheets can appear in many different forms and in many different situations. However, the accounting equation will not change. Therefore, whether the balance sheet appears on a corporate tax return, or loan application, or is used to illustrate the value of a marital estate, the basic equation remains the same.

STANDARDS FOR VALUING ASSETS ON BALANCE SHEETS

Different standards of value are applied to assets for different purposes. The same asset may be stated on different balance sheets at different values depending on the purpose of the balance sheet and the goals of its preparer. An investigator must understand the differences between the standards of value and under what circumstances each standard may be used on a balance sheet to properly analyze balance sheets during an investigation.

Fair Market Value. The standard of value that is applied in most divorce situations is fair market value. The term is most commonly defined as what a hypothetical willing buyer would pay a hypothetical willing seller.

Take, for example, a six year old dining room table. The fair market value of the table would be the sales price if it was going to be sold on the open market. A six-year-old table with an original purchase price of $8,000 may sell for $1,000 or less. Consequently, the fair market value of the table that should be included in the marital estate in this example is $1,000.

Purchase Price. Purchase price refers to the historical cost of an item. In our example, the table was purchased for $8,000. Therefore, under the purchase price standard of value, $8,000 would be the declared value of the table. It would not be unusual to find that one party to a divorce included this value in the marital estate and the other party declared the fair market value of $1,000.

Book Value. If the table was owned by a business, its value would be the purchase price less depreciation. If we assume that the business was writing off (expensing) the table over an eight-year period using a straight line basis then the table would have been depreciated for six years. Depreciation per year is $1,000 (8,000 ÷ 8). Total depreciation would be $6,000 (6 x 1,000). Book value would then be $2,000 (8,000 – 6,000).

Replacement Price. Replacement price refers to the cost of replacing an asset. In our example, assume that the wife claims that she will have to spend $10,000 to replace the table after the divorce is final. Consequently, she values the table at the $10,000 amount. Investigators might consider motivation in this type of case. If the wife is assuming the husband will get the table, she may be motivated to insure that he will be assigned a high value. If, however, she was assuming that she would end up with the piece, it is highly possible that she would select some other standard of value.

Sentimental Value. People develop emotional attachments to property. This may be because of the association of the property to a beloved individual, or that it represents evidence of achievement, or simply because some individuals define themselves by their possessions. In our example, if we assume that the table was a gift from the wife's mother and that it has very special meaning to the wife, it might be that the wife places a very high value on the piece which bears no relation to its actual worth. She might not be willing to declare the value as being high, but in fact would be willing to trade assets worth $12,000 to make sure she received it.

Estimated Value. In order to expedite proceedings or simply because of missing information, guesses may be made as to the value of assets. These guesses may be informed or not. In our example, the husband has no idea what the table is worth, thinks arguing about it is ridiculous, and estimates its value at 50% of the purchase price, or $4,000. Estimates by uninformed or adversely motivated individuals may represent little more than fiction or tools of vengeance.

Synergistic Value. Assets may have a value to a particular buyer. This is contrasted to the hypothetical buyer in the fair market value standard. This means that one buyer is willing to pay more for something than anyone else because it provides him or her with an economic advantage.

In our example, assume that the table was part of the dining room set of a famous movie star who died under mysterious circumstances at the table. Assume also that a collector has all of the chairs and other pieces of the dining room set, but not the table. The collector knows that if he can complete the set, his collection will skyrocket in value. Therefore, he is willing to pay more for the table than anybody else or $25,000.

Fair Value. The term fair value can be defined in a statute or left up to a court to decide. For example, if the court was presiding over the table in our example, it might decide that a fair value for the piece of furniture would be $25,000. That is, in the circumstances of the case, the value should be assessed at the price that could be obtained from the collector.

In summary, the table in the example could drive the following values:

Fair Market Value	$ 1,000
Purchase Price	8,000
Book Value	2,000
Replacement Price	10,000
Sentimental Value	12,000
Estimated Value	4,000
Synergistic Value	25,000
Fair Value	25,000

LIABILITIES ON BALANCE SHEETS

The identification of liabilities in the valuation of marital estates is usually not a major issue. Divorcing couples understand that the higher their liabilities, the lower the value of the marital estate, and the less they will have to share. Or they know that the more liabilities they have, the more assets they may receive in order to compensate them for having the debts. In any case, there is rarely a reason why anyone in a dissolution would want to conceal debts.

However, there is a pervasive exception to this general rule. Liabilities are incurred to obtain assets. A liability can be incurred to secure cash, buy inventory, or purchase a boat. The presence of a liability without a corresponding asset may indicate a missing asset. For example, assume that an investigator discovers an undisclosed liability for property taxes. The presence of the tax liability without the disclosure of the associated property may indicate an undisclosed parcel of land.

Contrary to the valuation problems encountered in relation to assets, there is usually very little doubt as to the valuation of debt. For example, a VISA bill is the amount due. This amount does not have to be adjusted to fair market value; the amount due is the fair market value of the debt.

As usual, there is an exception to the general rule. It happens when a spouse, usually with significant debt, enters into negotiations with creditors. The spouse can initiate these types of negotiations with the assistance of a credit counseling organization, an attorney, or on his or her own. In essence, the spouse offers to settle the debts below their face amount or for more lenient payment terms.

Normally, the payment of a debt at less than its face amount requires an immediate payment of some percentage of the total. This can cause a misstatement of the marital estate. For example, assume that a wife negotiates with her credit card company. She offers to pay $7,500 immediately to have her $10,000 amount due paid in full. She has listed the $10,000 as a debt in the marital estate. This means that the liabilities on the marital estate are overstated by $2,500. If this is not corrected, she will receive $2,500 more of the marital estate than she is entitled to.

Timing of the valuation of debts may be an issue. That is, a question can arise as to when debts are to be included in the marital estate and when they are excluded. For example, in many states, the date of divorce is the date of valuation of the marital estate. In those states, every debt that is incurred up to the date of divorce is included in the marital estate. Other states have provisions by statute or case law that provide for other dates of valuation such as the date of filing, the date of separation, or a date set by the court. Including liabilities that should not be included has the same effect on the marital estate as omitting assets.

SOURCES OF BALANCE SHEETS

- **Marital Estate Disclosures.** The standards of value represented in disclosures for the purpose of marital dissolution will be varied.
- **Loan Applications.** The standard of value represented in loan applications is generally (and lending institutions usually require it to be) fair market value.
- **Personal Financial Statements.** The standard of value represented in personal financial statements is normally fair market value.
- **Business Financial Statements.** The standard of value represented in business financial statements is normally book value. However, in the interest of full disclosure (or to assist an owner in getting a loan) CPAs may reference fair market values of assets in the notes to the financial statements. They may also prepare supplemental financial statements on a fair market value basis.
- **Business Tax Returns.** The standard of value used in the balance sheets of tax returns is normally book value.

MARITAL ESTATE DISCLOSURES

Balance sheet analysis for the purpose of finding hidden assets starts with the marital estate disclosures. These documents are required by most jurisdictions. They list the assets and liabilities of the divorcing couple.

Some jurisdictions put the disclosures into a balance sheet format. That is, the assets are listed in columns, then the liabilities. A difference is then determined to illustrate the net worth the couple has to divide. Other jurisdictions simply require the assets and liabilities to be listed in paragraphs or some other written format. Whatever the case, investigators should put the assets and liabilities into balance sheet format for purpose of analysis.

Once the restatement is completed, the analysis starts with a comparison of the marital estate disclosures to information that is available. The first comparison that is often performed is the comparison of one spouse's disclosure to the other spouse's. If the disclosures of assets and liabilities don't match, there may be an indication of a missing asset or an error.

After disparities in assets and liabilities are addressed, the investigator turns to valuation issues. It is not unusual to find several different standards of value applied in marital estate disclosures.

The investigator's job is to restate each value to fair market value. Real estate and businesses normally require expert appraisers. Significant collections of jewelry, guns, antiques, coins, stamps, art and other items may also require appraisers.

Values of automobiles and other vehicles may be found online by referencing one or several of the resource sites available. Significant differences in vehicle values or custom vehicles may require an appraiser. Household goods normally do not retain significant value therefore the cost of an appraisal should be assessed carefully in relation to the expected value of the household goods.

The reason the adjustment to fair market value is necessary is to limit the risk of assets being hidden in plain sight. For example, a husband may list the value of his business at $200,000, which is the book value of the operation. However, an expert business appraiser may determine that the fair market value of the business is $550,000 because of the amount of money the business earns. The existence of the business has been properly disclosed. The book value has been disclosed, but the standard of value that the court may apply is fair market value.

LOAN APPLICATIONS

In order to grant loans, banks usually require a balance sheet and income statement. The bank may request personal financial statements or have its own balance sheet and income statement forms. In requesting a balance sheet, the bank is seeking assets to secure the loan or at least an overall financial picture that will be favorable to getting the loan paid back. The income statement is requested to insure that the borrower has adequate cash flow to make the loan payments.

These statements can provide essential information in valuing marital estates. This is because loan applicants are highly motivated to secure the loan requested. This means that they are likely to disclose all of their assets to paint the most favorable financial picture possible. They will also not be shy in assigning values to assets. In the business example above, it is highly likely that the business owner would enter the value of the business at $550,000 rather than the $200,000. These statements, therefore, are an effective counterpoint to the asset disclosures made during the course of a divorce. The assets in the disclosures may be understated or undervalued, but since the motivation in the statements presented to the bank is the opposite, all assets will normally be presented and their values may actually be overstated.

PERSONAL FINANCIAL STATEMENTS

Occasionally, individuals will prepare, or have prepared for them, personal financial statements. These statements are normally prepared in conjunction with attempts to obtain loans. However, there may be other reasons that a personal financial statement may be prepared. For example, partners in a joint venture may require that personal financial statements be exchanged in order to be able to assess relative risk and insure that enough capital is available for the venture. The procedure for analyzing the statements is the same as that described under Loan Applications.

BUSINESS FINANCIAL STATEMENTS

Financial statements prepared for businesses are on the book value basis. That is, the assets are listed at their purchase price and depreciation is deducted from their value. The book value of an asset may or may not reflect its fair market value. For example, assume that land on the business balance sheet is valued at $10,000. This is the price that was paid for the property twenty years ago when the business started. The fair market value of the land today is $250,000.

Business financial statements can be generated by the business itself or by a CPA who is contracted for their completion. In general, the credibility of the financial statements depends on who creates them and on what terms. The least credible are the statements prepared by the business. This is because the skill of the preparer may be questionable or the preparer may be highly motivated to skew the statements in a particular direction.

Next in line are statements compiled by a CPA. A compilation consists of information that is put together in financial statement form by a CPA. The CPA is under no responsibility to assess the information presented, but if she happens to notice something out of line, she will usually question it. The next most credible statements are reviewed statements. The CPA reviews the financial statements for reasonableness and continuity. Finally, there are audited financial statements. These statements are not only reviewed by the CPA, but the underlying transactions that make up the statements are tested. However, unless otherwise clearly stated, all of these financial statements are presented on the book value basis. As noted, this standard of value may not be appropriate for marital dissolutions.

One of the first steps in professional business appraisals is to address the difference between book value and fair market value of the assets of the business. This difference is usually resolved by the use of real estate and equipment appraisers. The financial statements are then adjusted to reflect fair market values and liabilities are subtracted from the asset values. The difference is usually the minimum value of the business. That is, if the business stopped doing business, sold everything, and paid off its debt whatever is left over is the minimum value of the business. While this value may be useful as a starting point for the business value, the use of a qualified business appraiser may be the only alternative in assessing the value of a business for marital dissolution purposes.

BUSINESS TAX RETURNS

The balance sheets presented on tax returns are condensed versions of the financial statements that the business prepares or has prepared for it. They are prepared on a book value basis. Because of their condensed nature, their usefulness is limited. That is, investigators may only be able to note changes in major asset and liability categories. However, the presence of major changes in the total assets or liabilities of a business provides the basis for obtaining the detail associated with those changes.

FINANCIAL STATEMENT REVIEW

Once the balance sheets have been obtained, several standard procedures are normally performed. First, the statements are compared to themselves. That is, the balance sheets are summarized in columns; one column for each year. Then the assets are traced from year to year. If an asset disappears, it could be an indication that the asset is being hidden, or that it has been sold, or it has been traded. In any case, an explanation for the missing asset is sought.

The equity of each year is then reviewed. That is, the net worth of the subject is traced from year to year. A decrease in net worth over time may be a symptom of missing assets or debt incurred in an attempt to reduce the value of the marital estate. A sudden decrease in equity, especially after the date of first indication, is an obvious red flag that should be pursued.

The next step is to compare the balance sheet, typically the most current, to the marital disclosures. Discrepancies in the presence of assets and liabilities and their values are noted and explanations sought.

> ***Example:*** An investigator working for the wife reviewed the balance sheets for the husband's manufacturing business that were included as part of the business's tax returns. The investigator noticed that the book value of the equity had declined by more than $80,000 from the year preceding the divorce to the year in which the divorce was filed. When asked to explain the discrepancy, the husband finally admitted to having sold a building and produced a purchase and sales agreement for $125,000. The husband was unable or unwilling to account for the sales proceeds. The wife's attorney put the $125,000 into the marital estate and indicated that it was an asset that had been received by the husband, which the husband did not dispute.

IV. THIRD PARTIES AS SOURCES OF FINANCIAL DATA

Banks, insurance companies, merchants and vendors can all be sources of useful information in a hidden assets investigation.

OBTAINING INFORMATION FROM THIRD PARTIES

Although, the investigator can simply ask for information about the suspected spouse, often the source will be wary of providing it due to customer loyalty or fear of liability. The spouse making the hidden assets claim may be able to obtain the information, especially if that spouse's name is on the account or policy or the spouse is also a customer.

The subject of the investigation can sign a release. A properly worded release provides an investigator with a wide range of information that can be reviewed quickly and efficiently. In addition, resistance to signing a release may indicate the direction an investigation should take. There may be a very good reason why someone does want not certain information disclosed.

Finally, there is the hard way—a subpoena. Subpoenas can be time consuming, inefficient. They have limited value in cases in which the exact nature of the information sought is unknown because the subpoena typically has to specify what the investigator wants. A judge court may quash the subpoena if the judge believes it is too vague or intrusive.

BANKS

Financial institutions can possess a wealth of information for hidden asset investigations. The strategy of following the money in seeking hidden assets can actually begin and end at the subject's financial institution.

Banks are normally very knowledgeable concerning their legal rights and the rights of their clients. They are also very conscious of the liability they can incur if they damage, or appear to have damaged, one of their patrons. Consequently, a subpoena is often the only way to get information directly from a bank.

What the investigator needs first is a list of services that the bank is providing to the subject spouse. The investigator simply can't ask effective questions without understanding the services a bank is providing.

> ***Example:*** Pursuant to a subpoena, the wife' bank gave the investigator a list of services provided to her. One of the services discovered was a loan, which the wife had failed to disclose. Once the investigator learned of the loan, he was able to ask relevant questions. What was the loan for? (It may be an undisclosed asset.) How much is the loan for? (The value of the loan may be equivalent to the value of the asset not disclosed.) When was it received? (If the timing was after the date of first indication the loan may have been prompted by the divorce process.) What is being used to secure it? (The security may be the asset that was purchased or secured by another asset which may not have been disclosed.)

INSURANCE COMPANIES

Individuals who own vulnerable assets such as, houses, vehicles, and art are likely to insure them. And while some spouses may consider not protecting a vulnerable asset to keep it hidden, many others will not. Therefore, insurance policies may indicate the existence of undisclosed properties.

If the spouse's name is on the policy, then the insurance company will usually assume that the spouse has the right to review the policy and determine the nature of the assets being protected. When the policies are being held only in the subject's name, a subpoena may be required.

MERCHANTS AND VENDORS

Vendors and merchants vary considerably in their willingness to provide information to investigators. The investigator's approach will usually make a difference in the amount and quality of information received. When the investigator does not threaten or intimidate and simply begs for help, a surprising number of vendors will give the investigator whatever is asked for. On the other hand, some merchants and vendors will flatly refuse to provide any information and will feel obligated to tip off the subject thus notifying him or her of the direction of the investigation.

The spouse may be the best person to attempt to obtain the needed information. Very often both the husband and the wife are listed on merchant and vendor accounts. This gives the spouse automatic access to the account information. Even when only the subject's name is on the account, the merchant or vendor may assume that the spouse has access and provide all information requested.

CASE STUDY #3: THE SECRET JEWELRY PURCHASE

Melanie told her attorney that she believed her husband Alex was hiding assets and that she suspected he was having an affair. The attorney called in an investigator to determine if there was a basis for further investigation. As the investigator interviewed Melanie, he couldn't help but notice that she was wearing several expensive looking rings and a diamond bracelet. Melanie told the investigator that Alex had often given her jewelry as a gift during happier times in their marriage.

The investigator suspected that since Alex had used jewelry to keep personal relationships in the past, he would use jewelry in the future. The investigator also knew that Alex bought larger quantities of jewelry than most people. Quantity purchasers expect or demand discounts and very often get them. Therefore Alex was likely to return to the store where he had a history. The investigator asked where Alex usually got the pieces. Melanie responded that most of them came from a local store.

The investigator asked Melanie to go to the jewelry store and tell the owner that she would like to make sure that the pieces that she had were listed on the couple's insurance policy. Melanie did as requested and discovered that there was a $6,500 ring in the jeweler's records that she didn't have. She had a copy of the receipt and it was dated for about a month after the couple had separated.

The ring was a discovery foothold. Not only was it an undisclosed asset, it was an asset that could be used (if necessary) to inflame the sensibilities of the court. Without actually saying it, the attorney could let the judge fill in, "Your honor, Melanie's husband couldn't even wait to settle one relationship before beginning another. And your honor, he tried to begin the subsequent relationship by taking assets from Melanie to do it!" Alex, who had to this point been dragging his feet on certain discovery items, such as credit card statements, became altogether more cooperative.

V. PLACES TO LOOK FOR HIDDEN ASSETS

RELATIVES

Family ties can provide the means for concealing assets during a divorce. Parents will protect children, children will protect parents, and siblings will protect each other. The resolve of the protectors will vary from case to case. The divorcing party doesn't want his or her relationship with a family member damaged. In most cases, he or she wants to protect the relationship more than the asset. Therefore, the threat of steeping a relative in the legal process may get the spouse to reveal an asset held by a relative. In addition, while a relative may additionally agree to hide an asset, the relative may very quickly draw a new line when it becomes obvious that he or she is about to become embroiled in the legal process.

FRIENDS

Similar to family members, the emotional bonds between friends may provide a means of hiding assets. However, these relationships tend to be more fragile. Pressure of any type may break the resolve of an abettor. This category also includes new significant others. Pressure, or even threatened pressure, on the relationship may easily break the combined front of the new couple.

PAWN SHOPS

Individuals who have historically dealt with pawn shops may continue to deal with them during the course of a divorce. Trading assets for a pawn ticket and cash may provide a quick means of securing assets from an inquiring spouse. Some pawn shops fit the profile are even set up set up to take pawns on vehicles, planes, or real property. Pawns entailing hundreds of thousands of dollars are possible.

ART STORAGE FACILITIES

In addition to being inherently valuable, works of art may be environmentally sensitive. That is, some art, such as paintings, may require specific temperature and humidity ranges in order to retain its value. Some art owners seek out these facilities to store their collections when they are on vacation or change residences for major portions of the year. Historical use of these facilities in the past may provide a productive line of inquiry during a divorce.

CASINOS

Many gambling establishments accept fund transfers from their clientele. That is, a player may simply instruct his or her bank to send funds to the casino that will presumably be used for gambling. The casino holds the money until the player shows up and then issues chips or other gambling credit. When the player has had enough, he can then instruct the casino to wire his remaining funds back to his account.

However, there is nothing prohibiting the spouse who transferred the funds from telling the casino that there has been a change of plans and to send the money back. Therefore, the hiding spouse can show where the money went and claim that it was lost.

This same procedure can be accomplished using cash. The cash is deposited in the casino and then later retrieved by means of a wire transfer. This process looks a lot like money laundering procedures utilized by drug dealers. Casinos must have procedures in place to detect and defend against this type of activity. Consequently, spouses who attempt this scheme may find themselves on the receiving end of unsubtle questions from the casino or federal authorities.

COMPUTERS

Like any other document storage device, computers can be a valuable source of discovering hidden assets. However, an investigation into electronic media can be expensive. Hiring a computer forensics expert to find $5,000 is simply not worth the exercise. Seeking a suspected two or three hundred thousand dollars probably is.

In the case of computers, the best and surest way to initially preserve the evidence is to unplug the computer. Computers can be designed to erase key evidence if they are not shut down using a proper sequence or providing a password. Unplugging removes the operational capability of the system. The next step is to have the hard drive duplicated or imaged. This is done by a professional who understands the rules of evidence. The imaging is in contrast to installing software on the original hard drive which then transfers the data to another hard drive. Nothing should be installed on the original hard drive. Any action other than spinning the drive to mirror it can result in claims of altering the evidence recorded on the drive.

After the original drive has been duplicated and secured, the retrieved data can be reviewed either by specialized investigators or the spouse. Spouses know the habits of the subject and can spot files, folders, e-mails and documents that appear unusual. Specialized investigators are valuable because they can run search programs for key words or file names. Their searches will also encompass files that have been erased. When a computer deletes a file, it simply removes the header of the file. This is a little like tearing the file label off of a manila folder. The title of the file is gone, but not the documents themselves. Therefore, if the computer hasn't stored something else where the deleted document is located, it still exists on the hard drive.

CASE STUDY #4: BACK-UP TAPE BLUFF

Emily and her husband Aaron were the co-owners of a gift shop. Aaron had lost his mother about two-and-half years ago and his behavior from that point had changed remarkably. Emily explained that he had become distant, secretive, and had become obsessed with his health to the point of becoming a hypochondriac. She also indicated that the finances of the couple had begun to suffer beginning with the first tourist season after his mother's death. They had begun having trouble making payments to vendors and had stopped taking their normal winter vacation. Aaron had told her it was because the shop wasn't doing well. However, while Aaron was in charge of the bookkeeping and finances, Emily was in charge of merchandising. She related that she was ordering more merchandise than ever and that she had maintained or increased the average markup (excess of sales price over merchandise cost).

The disparity between the merchandise ordered and the apparent income of the couple was enough to require an explanation.

Emily had a back up tape on which were the business's books, but digging into the tape was going to take time and money that she didn't have. Her attorney told Aaron's attorney that the tape had been provided to a forensic investigator for complete analysis.

The ploy worked. Aaron submitted a revised asset and liability disclosure within a few weeks. The difference was in the value of Aaron's stamp collection. He had doubled its value since the initial disclosure. Emily's attorney smelled blood in the water and demanded a full inventory of the collection plus any associated data related to the collection, like appraisals. What Aaron surrendered was a complete inventory including purchase price, date of purchase, dealer, and revised market values. Even after Aaron had doubled the disclosure amount, the total value of the collection was still understated.

VI. THE BUSINESS OWNER

BUSINESSES CAN BE USED TO HIDE ASSETS

A business may be an ideal venue for keeping assets from a spouse. Transactions that can have a large effect on the marital estate may be camouflaged by the large transactions that normally occur in a business. Some business owners can exert total control over the operations of a business defeating internal controls and normal bookkeeping procedures. The high risk situation exists only when a business owner can exert significant control of a business and its transactions, not when the owner is a minority shareholder or has little control over business operations.

Finally, a business may be a significant source of income for a couple. Following the money may indicate where assets could have been hidden.

INFORMATION NEEDED TO BEGIN THE INVESTIGATION

The information necessary to begin a business investigation is the same as for a wage earner — the bank statements and the check registers. The difference is that the bank statements and the check registers are needed for both the couple's personal account and the business account.

The investigator will review the business account for how money comes into the business, interbank transfers, and unusual bank transactions. The review of the check registers will focus on payments made to or on behalf of the owner, large or unusual transactions, and non-business expenditures.

INTERVIEWING THE PARTIES

If given the opportunity, the investigator will want to interview the business owner concerning unusual transactions in the bank statements and questionable items in the check register. The investigator will also interview the business owner's spouse and ask that he or she review the bank statements and check registers of the business.

There are a number of good reasons for this approach. First, the spouse may have been involved in the business and have as much or more information than the business bookkeeper. Second the spouse may be the business book-keeper or may have been in the past. Third, the spouse may recognize payments to relatives, dress shops, girlfriends, questionable vendors, or unfamiliar credit cards that the investigator will not. Fourth, educating the spouse on the income of the business and how it spends its money may either show the spouse that his or her concerns of hidden assets are unfounded, or that the spouse likely has a valid claim.

CASE STUDY #5: THE BOGUS BUSINESS EXPENSE

Wanda owed a hair salon and day spa. Ed, her husband, didn't know anything about the business, had never been involved with it, and really didn't want to have anything to do with it. Ed's attorney asked him to review the business checking account. Ed told the attorney in no uncertain terms that he was being ridiculous. The attorney persisted and

Ed decided to take a look. He was shocked to see that Wanda was paying four thousand dollars a month to John, the tennis pro at the country club.

Ed's attorney added all of the payments that Wanda's business had made to John back into the marital estate. Although Wanda made a half-hearted attempt to defend the payments, it faded when she was asked for John's job description, time records, and Ed's attorney suggested John be deposed.

COUNTERING THE BUSINESS OWNER'S RESISTANCE

The business owner may resist the investigator's efforts to obtain the bank statements and check registers. The reasons given by the business owner for not producing the documents range from client confidentiality concerns, to undue burden, to claims that the disclosure will reveal operational secrets to the business's competitors.

For example, the owner of a medical practice may express concerns related to the Health Insurance Portability and Accountability Act (HIPAA) which has strict patient confidentiality provisions. The counter to the claim is to point out that the bank statements and check registers do not normally include any patient information.

A claim of undue burden is countered by indicating that most businesses of any size have automated bookkeeping systems. Production of the check register entails pushing a button.

While it is true that a vindictive spouse could damage a business by revealing operational secrets, the check register and bank statements do not usually contain information that could be used in this manner. If the business owner illustrates that secrets could be revealed, the investigator can counter with provisions that insure that only the investigator and not the spouse will be allowed access to the information.

The arguments that the business owner offers for not providing the documentation requested often have little to do with the real reason the owner does not want to disclose the records. The owner may have claimed personal expenses as business expenses or have unreported income. This puts the business owner in a position of revealing questionable tax reporting. If this is the case, assurances of confidentiality may go a long way towards obtaining the records. On the other hand, if the owner has expenditures or income that he or she does not want to reveal to the spouse, assurances of any type are unlikely to move the business owner.

The resistance by itself can be a clue that something is amiss in either the disclosed income or the assets of the business owner.

Another means of forcing the hand of the owner is to apply logic to the situation in combination with the personal knowledge of the spouse.

> ***Example:*** A wife knows that she and her husband went on a vacation two years ago. The wife knows that the cost of the vacation was not paid for through the couple's personal account. Therefore, the business had to pay for the vacation. The owner husband is forced to show that the amount was assigned to him as compensation, or that the cost was recorded in the travel expenses of the business. Either way, the investigator has learned something. Either the husband has considerable control over the amount of income he receives from the business, or personal expenses are being claimed as business deductions for tax reporting purposes. Both can be used to adjust

the income the husband has available for child support or alimony and can also provide a source for assets that have been hidden.

THE FORMULA FOR DETERMINING THE POSSIBILITY OF MISSING ASSETS

Once the investigator has determined the net income of the business, the following formula can be used for determining the possibility of missing assets.

Net Business Income − Personal Expenditures = Missing Income or Assets

The net business income comes from the tax return. The personal expenditures are determined by review of the couple's personal checking account. The difference is missing income, which may exist in the form of assets. The amount of income is known; the amount that was spent is known. The figure that has to be explained by the business owner is the difference.

Depreciation can be used to further develop the formula. Depreciation is treated as an expenditure, even though no cash is actually spent.

Most businesses need assets to operate and the depreciation expense allows them a means of recognizing the cost. However, if a business owner does not replace assets, then the cash is available to be spent. The depreciation expense claimed by the owner is taken from the tax return. The formula used to indicate that the owner has this cash available (and it may be missing) is:

[Net Business Income + Depreciation] − Personal Expenditures = Missing Income or Assets